Beyond Compliance: How ESG Transforms Corporate Governance and Culture

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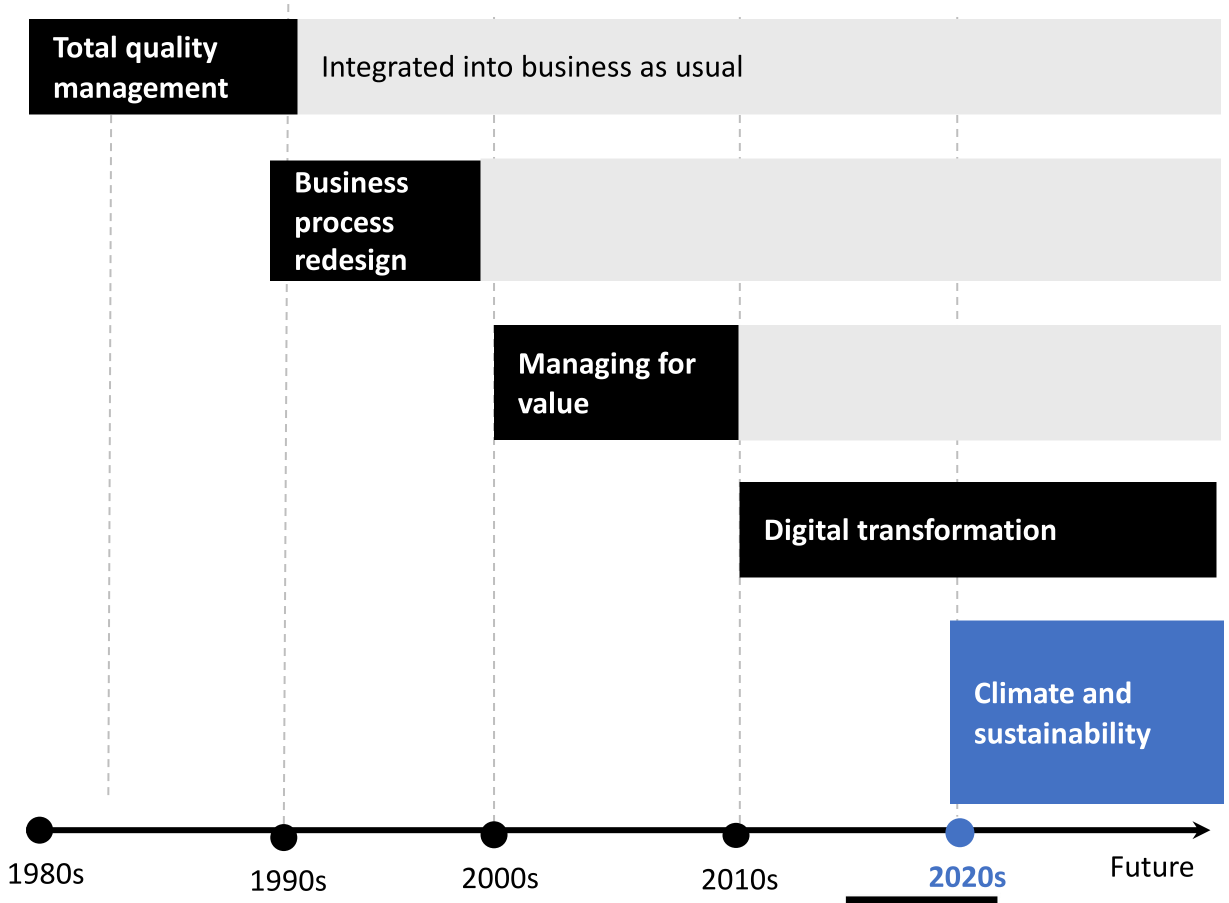
Sustainability in business refers to **the effect** companies have on the **environment and society**

It has moved to the mainstream of corporate thinking and is setting up to be the big driver of transformation

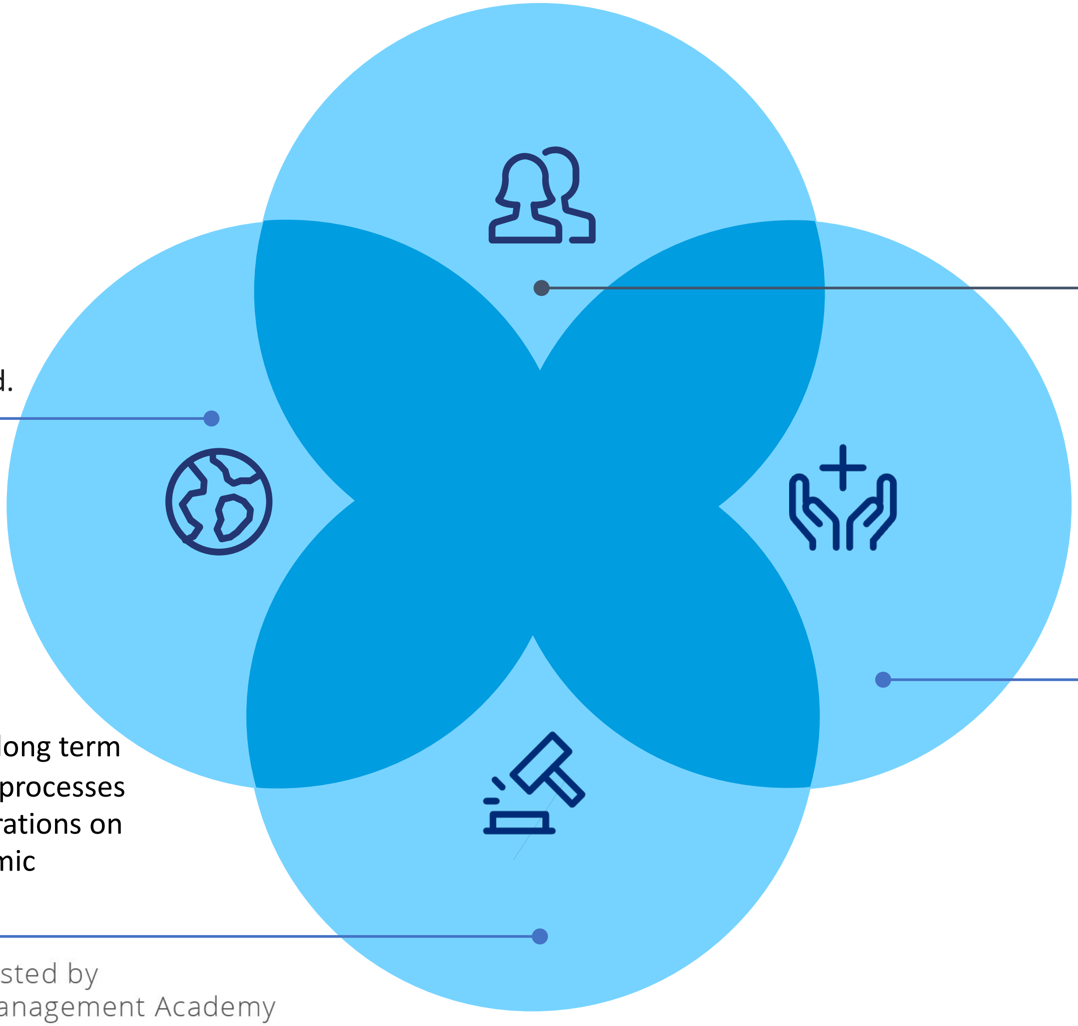
The growing adoption of sustainability reflects a shift in the role of corporations and a recognition that embedding sustainability into long-term business strategies competitiveness and create value for stakeholders. Doing well can be aligned with doing good.

- "There is one and only one social responsibility of business … to increase its profits." Milton Friedman, 1970[1]
- "Companies should serve not only their shareholders, but also deliver value to their customers, invest in employees, deal fairly with suppliers and support the communities in which they operate." Business Roundtable, Statement on the Purpose of a Corporation, 2019
- "Sustainability is not an offshoot of our business – it is our business." David Soloman, CEO, Goldman Sachs



Source: Friedman M. "A Friedman Doctrine," New York Times, September 13, 1970, available at https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html; See https://purpose.businessroundtable.org/

Four Pillars of Sustainability



Planet

Understand, evaluate and communicate how Company (through technologies, plants, processes, products) impacts natural resources (air, water, soil, biodiversity, etc.) and how they are used.

People

Understand, evaluate and communicate how the Company impacts people's dignity, equality, and health (e.g. Health & Safety, equality and diversity).

Prosperity

Create value and progress for themselves and wider community (wages, labor productivity, jobs, profits, shareholder compensation)

Principles of Governance

Corporate "Purpose" focused on long term value creation, good governance processes to assess the impact of their operations on environmental, social and economic spheres.

ESG is a **framework** that is used to **evaluate the performance** of companies in three key areas **– environmental, social, and governance – and drives decision-making**

Investors

1. **Over 90% of studies** on the connection between ESG factors and company financial performance show a non-negative correlation
2. Top 20% highest performers on material sustainability issues **outperform bottom 20% by as much as 5%** over a 20-year period

"Can you demonstrate that your
ESG **performance is within**

Regulators

3. Over **1800 climate-related laws** and policies are already in place globally
4. Over **500 sustainable finance policy instruments** are in place in the largest 50 global economies with 97% having been adopted since 2000.

"**Is your governance setup adequate** for the scale and complexity of your business?

Customers

5. Increased **reputation** translating into up to 11% higher market cap
6. 76% of consumers would **refuse to purchase a product** if a company supported an issue contrary to their beliefs
7. 66% of consumers globally (and 73% of millennials) are **willing to pay more** for sustainable brands

"Can you show me that **your business supports my values?**"

Employees

8. **55% higher employee morale**
9. Up to **50% reduction in turnover**, **saving 90-200%** of retained employee's salary
10. **16% higher productivity**, with measurable impact on shareholder value
11. D&I in particular is also known to drive innovation, making organizations **45% more likely to grow market share**, and 70% likelier to capture new markets.

"Does my (prospective) employer's ESG performance **align with my values?**"

ESG impacts **most functions** of an organization

CEO

- How are shifting ESG priorities impacting our reputation and share price?
- How do we balance long-term sustainability with short-term growth expectations?

COO

- How do our operations need to change?
- How do we align our supply chain to ESG commitments?

CFO

- How to assess ESG risks on the organization's balance sheets?
- How does our ESG profile impact our cost of capital?
- Where should we direct our capital?

CRO

- How does our ESG performance impact our risk profile?
- How to assess and reduce physical climate risk exposure?
- How do we protect ourselves against cyber risks?

General Counsel

- How are evolving ESG goals impacting our liabilities?
- How can we stay ahead of shifting regulations and SEC and other reporting requirements?

CSO

- How do we progress on sustainability and what is most important to our stakeholders?
- What should we report and which frameworks to use?

CHRO

- How do we integrate ESG metrics into local and global executive compensation programs?
- Do our ESG goals change our employee value proposition?

Not exhaustive

Benefits of a Strong ESG Profile

1. Facilitate top-line **growth** (e.g. expanding into new and existing markets)
2. **Reduce costs** (e.g. lower energy and water consumption)
3. **Minimize regulatory and legal interventions** (e.g. earn subsidies and government support)
4. **Optimise investment and capital expenditures** (e.g. avoid investments that may not pay off)
5. Improve the company's **reputation** and potentially lead to a better positioning among its stakeholders
6. **Risk Management** - capture and capitalise on less quantifiable risks and opportunities that may not be material to a company's creditworthiness at the time but possibly in the future
7. **Shareholder value** - lower cost of capital and improve value creation

The Links Between ESG And Financial Performance

Source: S&P Global Ratings.

Climate change is increasingly being separated from ESG management into its own function

Internal ESG view

External risk Management view

What is the contribution of my company to climate change?

What is the potential impact of climate change on my company?

ESG policy, climate friendly commitments, own footprint etc.

Integration of climate-related considerations into risk management framework, including governance and scenario analysis

Globally, and especially in **Asia** we are already experiencing **climate change impacts**

The physical basis: what we have recorded

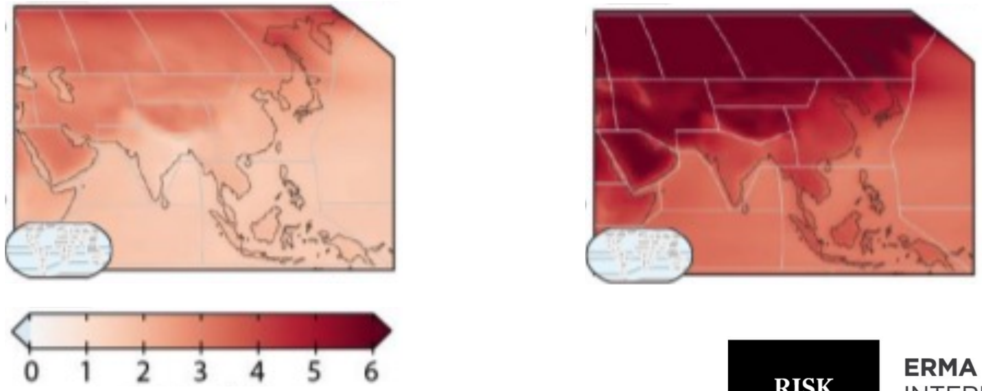
- Each of **the last four decades has been successively warmer** than any decade that preceded it since 1850
- Global surface temperature in the first two decades of the 21st century (2001-2020) was **0.99 [0.84-1.10] °C higher than 1850-1900**
- **Global surface temperature was 1.09 [0.95 to 1.20] °C higher** in 2011–2020 than 1850–1900, with larger increases over land (1.59 [1.34 to 1.83] °C) than over the ocean (0.88 [0.68 to 1.01] °C)
- The likely range of **total human-caused global surface temperature** increase from 1850–1900 to 2010–2019 is 0.8°C to 1.3°C, with a **best estimate of 1.07°C**

Manifestations in Asia

- Relative sea level around Asia has **increased faster than global average – 3.7mm/yr**
- **Droughts have become more frequent** in much of East Asia
- **Heatwaves and humid heat** stress **more intense and frequent** in South Asia
- **Heavy precipitation** will increase in frequency and intensity leading to **more landslides in East Asia**

Annual mean temperature

Change at 2°C global warming *Change at 4°C global warming*



Source: IPCC Assessment Report 6 (2021) *The Physical Sci*

Three vectors for how climate risks impact businesses

Physical Risk

Physical risks arise from damage to property, land and infrastructure from catastrophic weather-related events and broader climate trends such as heatwaves, hurricanes, droughts, floods and rising sea levels.

Transition Risk

Transition risks arise from changes in climate policy, technology and market sentiment as we adjust to a lower-carbon economy. The need to transition is widespread, affecting not only energy companies but also transportation, infrastructure, agriculture, real estate to name just a few.

Liability Risk

Liability risks arise from people or businesses seeking compensation for losses they may have suffered from the physical or transition risks of climate change. Liability cases can include people who have suffered from physical events, such as flooding, making claims against polluting companies who they argue are, at least in part, responsible.

https://www.bankofengland.co.uk/knowledgebank/climate-change-what-are-the-risks-to-financial-stability

The transition to a **low-carbon economy** is already creating **material enterprise risks**

'Flight shame' could halve growth in air traffic

Cost of polluting in EU soars as carbon price hits record €50

Price of carbon offsets has more than doubled from levels before Covid crisis

'Black Wednesday' for big oil as courtrooms and boardrooms turn on industry

Campaigners sense turning point as shareholders, boards and The Hague act to force Chevron, ExxonMobil and Shell to cut pollution

Beef farmers are the new coal miners

Red meat could be a casualty of EU's climate goals.

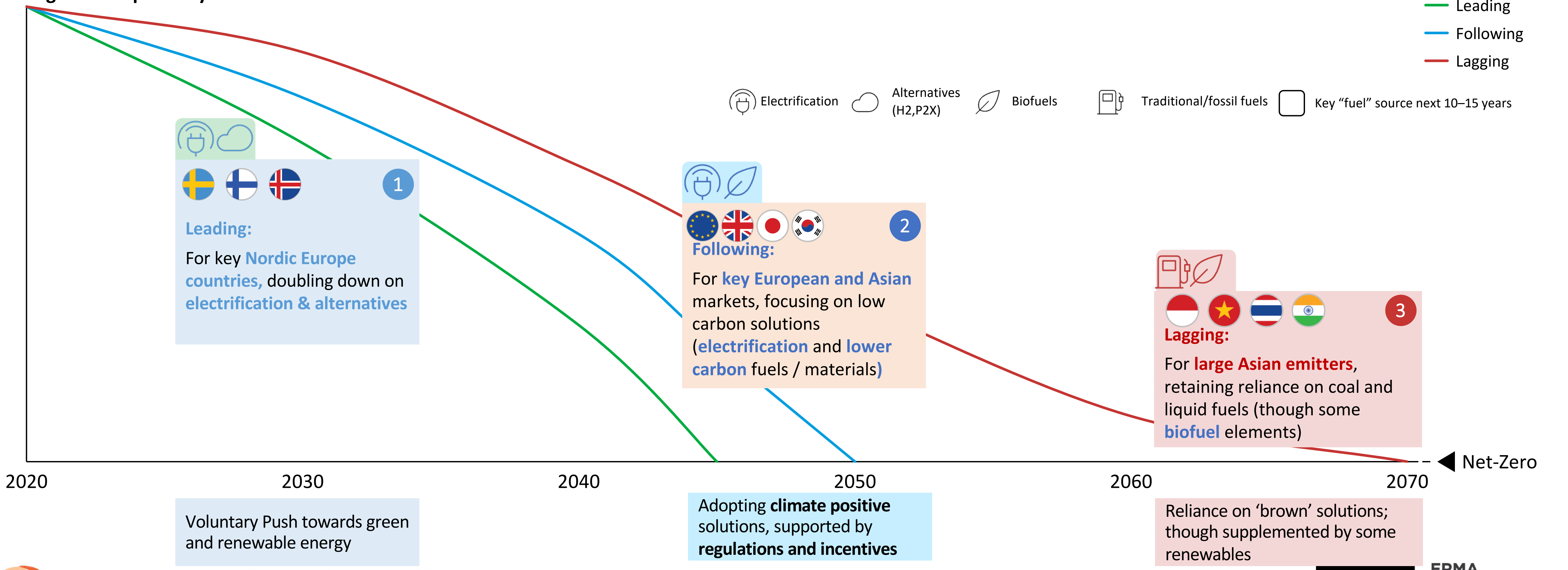
DWS probes spark fears of greenwashing claims across investment industry

BlackRock punishes 53 companies over climate inaction

How the world is responding

Globally, regions are choosing different decarbonization paths, driven by investment appetite and local realities; Meanwhile, industry coalitions are defining their own pathways as regulatory, customer and investor pressures rise

Progress and pathways towards net-zero



How pacesetters are responding

Since the 2000s, focus of businesses and governments on climate change has intensified, becoming a key transformation driver for the near future

IPCC (1990)
Established in 1988 by the UNEP to **provide governments** with **scientific information** to develop **climate policies**

UNFCCC (1995)
First global treaty to explicitly **address climate change**. Ratified by 197 countries, including U.S. **Conference of the Parties (COP) was established**

Kyoto Protocol (2005)
First **legally binding** climate treaty. It only required **developed countries** to **reduce emissions by an average of 5 percent** below 1990 levels

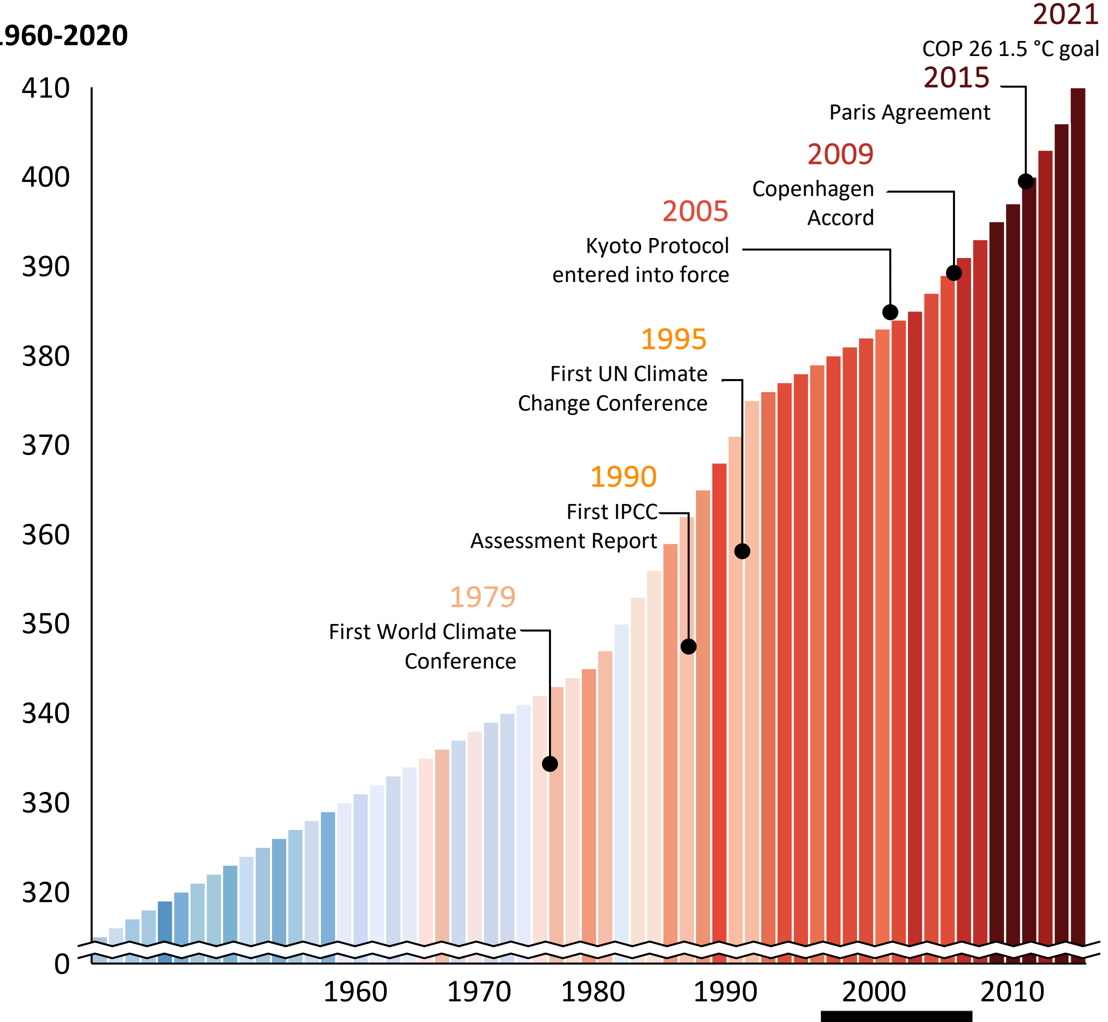
Copenhagen Accord, Cancun Agreements (2009)
Set a goal of **limiting global temperature increase to 2.0°C**; called on all countries to put forward mitigation pledges

Paris Agreement (2015)
Requires all countries to **set emissions-reduction pledges**, pursuing efforts to **keep it below 1.5°C**

COP26 (2021)
Calls on countries to **"revisit and strengthen" their 2030 targets** by end 2022 to align them to **1.5°C** goal. Other advancements include several countries signing up to the **Global Methane Pledge** to **halt and reverse forest loss and land degradation** and **phase out domestic coal**

Atmospheric CO_2 vs Global Temperature Change

1960-2020



Source: Climate Action Tracker

How pacesetters are responding

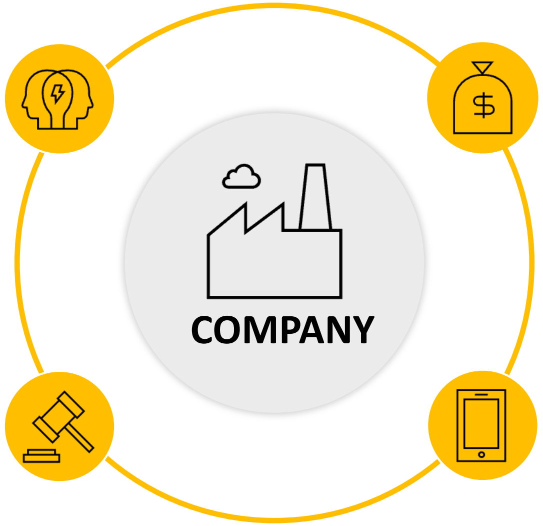
Stakeholders such as regulators, financiers, customers, vendors are increasingly guiding (and forcing) companies toward more sustainable and ESG friendly practices

Customers

- Preference towards **sustainable / green products**
- Push on suppliers / vendors to meet Scope III sustainability goals

Regulators & Rating agencies

- **Incentivizing sustainable industries and penalizing pollutive ones** e.g. EU Green Plan, SGX starting TCFD journey, Carbon markets
- Formalizing of rating agencies **assessment of companies' ESG-related performance**



Capital markets, financiers and private investors

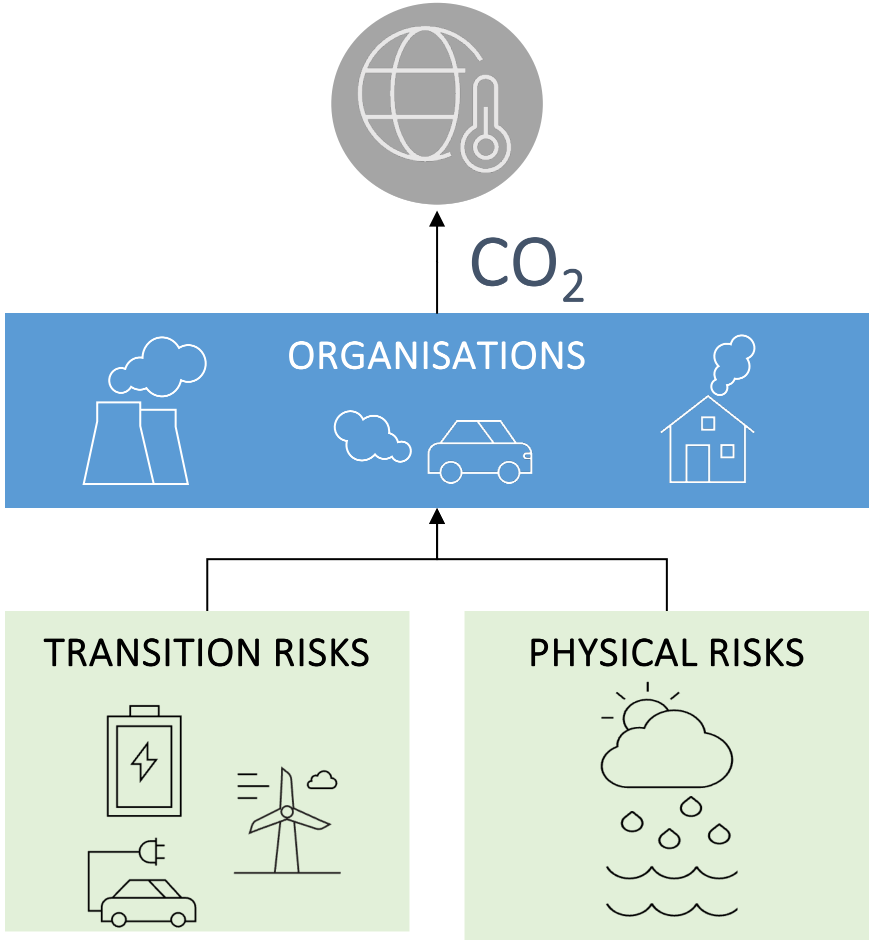
- **Higher cost of financing** for brown operations / assets
- Incorporation of **climate and ESG risks into lending approvals** *e.g. a Singapore conglomerate had global banks refusing to offer credit due to coal exposure in a single country*

Competitors and technology

- **Significant capital deployment by corporates and FIs into** disrupting existing 'brown' industry structures
- Emphasis on clean technology solutions to **integrate profitable growth with environmental benefits**

How should organisations respond?

There are two key questions which any organisation should consider, which fundamentally encompasses all stakeholders' priorities



A How does my organisation contribute to climate change?

- The impact of investments/activities on climate change (measuring impact of emissions e.g. warming potential)
- **Example action:** Setting emissions targets or committing to a net zero portfolio
- **Toolkit:** Emissions forecasting, Warming potential

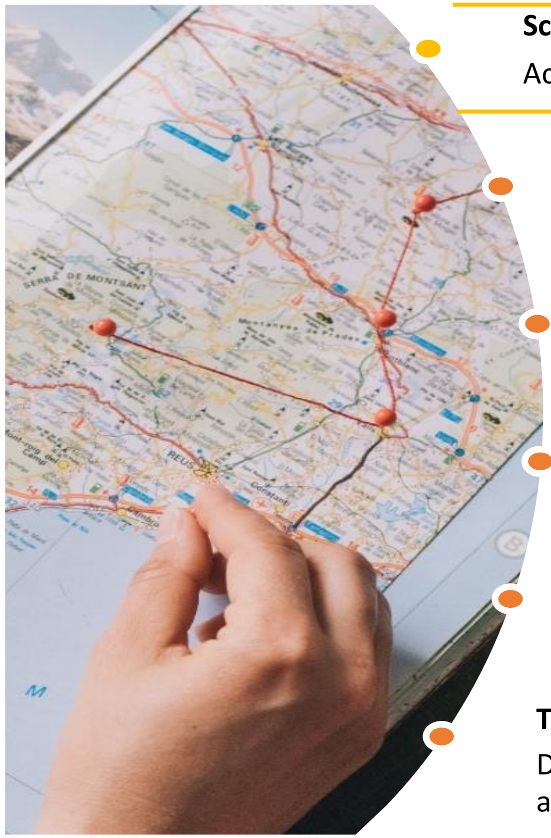
B What is the impact of climate change on my organisation?

- Financial risks (physical and transitional risk impact on revenues, credit, etc)
- Business interruption and physical damage to assets
- **Example action:** Avoiding sources of energy or using energy efficient buildings/equipment
- **Toolkit:** Scenario analysis

How should organisations respond?

Institutions have started to define their transition plans to actively facilitate decarbonization, assigning resources and analytical tools behind setting aggressive NZE targets for each part of their business

Essential elements of an effective transition plan



Science-based targets & metrics
Achievable & aligned to net-zero

Specific timelines & milestones
Incl. measurable, short-term commitments

Board approved
With regular progress tracking

Resourcing & budgeting
Appropriately allocated, committed and spent

Clear progress
Objective achievements, milestones & metrics on track

Transparent external disclosure
Disclosure of strategy, timelines, metrics and progress

Principles to set science-based targets

1. Ambition to meet Net Zero commitments
   – Targets shall align with Net Zero by 20XX under science-based scenarios

2. Meet business targets and objectives
   – Targets should consider business, competitive & financial implications, as well as commercial opportunities (to generate returns while supporting transition)

3. Support customer transition
   – Targets should be aligned with each company's commitment to its customers

Different industry speed to climate impact

We recognize climate risks may not be entirely existential for Asians companies right now, but the sands are shifting. Global peers are pre-emptively responding – to seed opportunities and strengthen core-climate processes

	Financial institutions	'High-carbon' industrials	'High-carbon' ecosystem	….
Who? are they	• Banks, Pension funds etc.	• O&G cos, "consuming industries" e.g. O&G, travel, construction	• Service providers to consuming industries e.g. ship-building; OEMs, MROs	
What? are they doing	• Net zero portfolio alignment e.g. phasing out financing of high-carbon industrials	• **Redesign** business processes and products/services offered • Support **carbon –ve initiatives**	• Measurement / optimisation of **carbon footprint** • **Seed opportunities for longer term customer needs** e.g. circular economy	
How? are they organising	• Build analytical capabilities to assess impact of **climate risk** and integrate into frameworks	• Incorporate **carbon taxes** and pricing in their internal models • Enhance **climate capital allocation and risk management** processes	• Strengthen **strategic planning processes** • Increase **climate resilience** of infrastructure • Implement **comm. programs** for external stakeholders	

Task Force on Climate-Related Financial Disclosures (TCFD)

Several climate-related initiatives vanish, but TCFD recommendations have been gaining traction, designed to generate actionable information

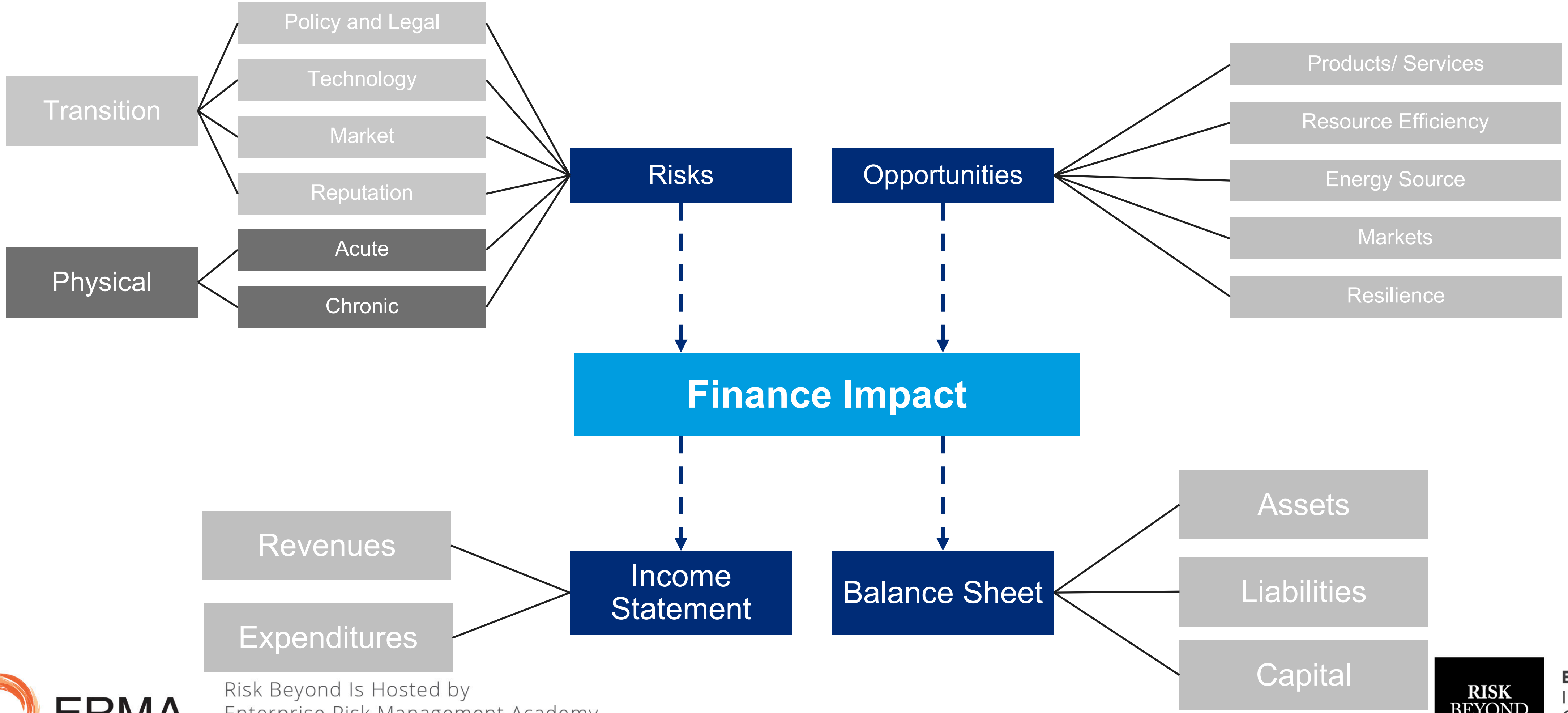
TCFD Background and Objectives

- The TCFD was established by Mark Carney and Michael Bloomberg to develop **voluntary, consistent climate-related financial risk disclosures** for use by companies in providing information to stakeholders
- The TCFD recommendations were developed to:
  - Generate **new sources of information** for market actors and policymakers and influence the **allocation of capital**
  - Facilitate the transition to **a more sustainable, low-carbon economy**
- More than **2600 global leaders** have signed on to the TCFD recommendations
- There are four core elements of the TCFD recommendations, shown to the right

TCFD Core Elements

GOVERNANCE
STRATEGY
RISK MANAGEMENT
METRICS AND TARGETS

Framework for thinking about risks, opportunities, and financial impact



5-step TCFD Risk & Resilience Roadmap

Where are you?

Risk managers, the Board & the climate lead have critical roles to play…

Quick-look Checklist

1. GETTING STARTED

- ✓ C-suite Sponsor, working group
- ✓ Climate committee
- ✓ Governance & risk oversight
- ✓ ID delivery/modelling partner(s)

2. CURRENT STATE ASSESSMENT

- ✓ Risk and opportunity ID & prioritisation
- ✓ Transition impact assessment
- ✓ Physical impact assessment
- ✓ Resilience assessment
- ✓ Carbon / GHG emission analysis

3. STRATEGIC PLAN

- ✓ Climate strategy statement
- ✓ Metrics & thresholds
- ✓ Value chain adaptation timeline
- ✓ Training

4. GOING LIVE

- ✓ Implement value chain changes
- ✓ Address physical resilience
- ✓ Target performance reporting
- ✓ ERM integration

5. TCFD REPORT

1. Pilot TCFD report ready for roll-out in annual report/accounts
2. Add to ongoing governance
3. Public facing coms & marketing

riskbeyond.com

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